



Gray Davis, Governor  
State of California  
Business, Transportation and Housing Agency

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980 Ninth Street  
Suite 500  
Sacramento, CA 95814  
916-322-1583 voice  
916-445-8399 fax  
rmartin@dmhc.ca.gov

IN REPLY REFER TO:  
FILE NO: 933-0195

June 6, 2003

David Kutner, President  
American Healthguard Corporation  
30 E. Santa Clara, Suite D  
Arcadia, CA 91006

**Re: Non-routine follow-up examination of American Healthguard Corporation**

Dear Mr. Kutner:

Enclosed is the final report of the non-routine follow-up examination of American Healthguard Corporation ("the Plan"), conducted by the Department of Managed Health Care ("Department") pursuant to Section 1382(a) and Rule 1300.82(a).<sup>1</sup> The Department issued a Preliminary Report to the Plan on March 25, 2003.

This final report is issued in accordance with Section 1382(c).

Section 1382(d) states "If requested in writing by the plan, the director shall append the plan's response to the final report issued pursuant to subdivision (c). The plan may modify its response or statement at any time and provide modified copies to the department for public distribution not later than 10 days from the date of notification from the department that the final report will be made available to the public. The addendum to the response or statement shall also be made available to the public".

Please indicate within ten (10) days whether the Plan requests the Department to append its response to the final report. If so, please indicate which portions of the Plan's response shall be appended, and provide copies of those portions of the Plan's response exclusive of information held confidential pursuant to Section 1382(c), no later than ten (10) days from the date of the Plan's receipt of this letter. If the Plan requests the Department to append a brief statement summarizing the Plan's response to the report or wishes to modify any information provided to the Department in its response to the

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<sup>1</sup> References throughout this letter to "Section \_\_\_\_\_" are to sections of the Knox-Keene Health Care Service Plan Act of 1975, California Health and Safety Code Section 1340, *et seq.* References to "Rule \_\_\_\_\_" are to the regulations promulgated pursuant to the Knox-Keene Health Care Service Plan Act, found at subchapter 5.5 of Chapter 3, Title 28, California Code of Regulations, beginning with Section 1300.43.

David Kutner, President  
American Healthguard Corporation  
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preliminary report, then please provide the documentation no later than ten (10) days from the date of the Plan's receipt of this letter.

**Ten (10) days from the date of the Plan's receipt of this letter, the Department will make the attached final report available to the public.**

If you have any questions regarding this report, please call.

Sincerely,

Richard Martin  
Supervising Examiner  
(916) 322-1583

Cc: Mark Wright, Chief Division of Financial Oversight  
Gil Riojas, Examiner  
Maryam Tahriri, Examiner  
Jane Genco, Counsel

**DEPARTMENT OF MANAGED HEALTH CARE**  
**REPORT OF NON-ROUTINE FOLLOW-UP EXAMINATION**  
**AMERICAN HEALTHGUARD CORPORATION**

**FILE NO: 933 0195**

**DATE OF FINAL REPORT: JUNE 6, 2003**

**EXAMINER IN CHARGE: MARYAM TAHRIRI**  
**OVERSIGHT EXAMINER: RICHARD MARTIN**

## **FINAL REPORT OF NON-ROUTINE FOLLOW-UP EXAMINATION OF AMERICAN HEALTHGUARD CORPORATION**

This is the final report of the non-routine follow-up examination of American Healthguard Corporation ("the Plan"), conducted by the Department of Managed Health Care ("Department") pursuant to Section 1382(a) and Rule 1300.82(a).<sup>1</sup> The Department issued a preliminary report to the Plan on March 25, 2003.

The non-routine follow-up examination was limited in scope. It entailed examining the actions taken by the Plan to correct specific deficiencies stated in the Department's final report of the routine examination dated October 16, 2001.

This final report includes a description of the compliance efforts included in the Plan's May 14, 2003 response to the preliminary report, in accordance with Section 1382(c). Our findings are as follows:

### **ADMINISTRATIVE CAPACITY**

Section 1367(g) requires every plan to have the organizational and administrative capacity to provide services to subscribers and enrollees, and Rule 1300.67.3 requires every plan to have staffing in fiscal and administrative services sufficient to result in the effective conduct of the plan's business.

In order to demonstrate adequate administrative capacity, a plan must have an executive staff and key management staff, which are properly dedicated to performing the necessary functions of a health care service plan. While a plan may enter into administrative service agreements with an affiliate or another company to purchase nondiscretionary, ministerial services, Plan management must perform the functions requiring the exercise of any judgment or decision-making. In addition, the responsibility for the day-to-day functions and the oversight of any delegated functions must reside with Plan management.

In March 2001, the Department conducted a routine examination of the Plan in accordance with Section 1382(a) of the Knox-Keene Health Care Service Plan Act. Based on the Department's examination it was determined that the Plan did not demonstrate adequate administrative capacity and the Department noted certain deficiencies as follows:

- The Plan delegated certain accounting and reporting functions, including the preparation of the quarterly Financial Statements, to an outside Certified Public Accountant ("CPA"), without the benefit of an administrative service agreement.
- The Plan did not properly monitor or supervise the services delegated to the CPA.

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<sup>1</sup> References throughout this letter to "Section \_\_\_\_\_" are to sections of the Knox-Keene Health Care Service Plan Act of 1975, California Health and Safety Code Section 1340, *et seq.* References to "Rule \_\_\_\_\_" are to the regulations promulgated pursuant to the Knox-Keene Health Care Service Plan Act, found at subchapter 5.5 of Chapter 3, Title 28, California Code of Regulations, beginning with Section 1300.43.

- The Plan did not maintain adequate books and records and written procedures.

The Plan was required to review all of its operations and specifically those functions performed on its behalf by the CPA for compliance with the administrative capacity requirements and to provide a copy of the administrative services agreement with its CPA. The Plan was also required to describe the corrective action taken by management to ensure that the Plan has sufficient staffing in fiscal and administrative services and proper written procedures for the effective conduct of the Plan's business, in compliance with Section 1367(g) and Rule 1300.67.3. The corrective action was to include a detailed description of all controls and procedures implemented by Plan management, as well as address the concerns noted above. In addition, the Plan was required to demonstrate that adequate oversight, authority, and responsibility have been retained by the Plan for all delegated functions.

As part of the response to the routine examination, the Plan stated all of its operations and specifically those functions performed on its behalf by the CPA for compliance with the administrative capacity requirements. The Plan also provided a copy of the administrative services agreement and the corrective action taken by management to ensure that the Plan has sufficient staffing in fiscal and administrative services and proper written procedures for the effective conduct of the Plan's business. The response also indicated that the Plan was committed to hire a bookkeeper to achieve the corrective actions.

In its December 21, 2001 letter to the Department, the Plan indicated that a bookkeeping service, Titan Management, had been hired instead of a bookkeeper to perform the services indicated in its corrective action plan. The Plan then indicated in its letter to the Department, dated May 16, 2002, that it was going to exercise its cancellation rights with Titan Management and phase out the service. The Plan also stated that it had hired a full-time bookkeeper to take over the functions of the bookkeeping service.

Our non-routine follow-up examination disclosed that (1) the Plan's full time bookkeeper had resigned and that a part-time bookkeeper had been recently hired, (2) Titan Management is still performing services such as bookkeeping and bank reconciliation, and (3) a part-time Controller had been hired.

The Plan was required to address all changes made to its original corrective action filed in response to the routine examination and to demonstrate that it now complies with the administrative capacity requirements of Section 1367(g) and Rule 1300.67.3.

In addition, the Plan was required to submit (1) an organizational chart indicating the name and title of its management and administrative staff, and (2) provide a detailed narrative of each individual's responsibilities and their time allocated to Plan business. The Plan was also required to provide a listing of its contractors for administrative services and a detailed description of the services performed by each contractor.

The Plan's response stated that its initial intentions were to have a Full-time Bookkeeper handle the day-to-day bookkeeping, bank reconciliation, and check handling. However, after implementing the process and examining the results, the Board of Directors felt that having the bookkeeper handle the checks, issue the checks, and reconcile the bank statements, could result in

possible security issues. So, in order to keep a segregated control of financial process the Board of Directors felt that the duties of Bank reconciliation's should be handled by a separate person and not incorporated into the duties of the Bookkeeper. This decision resulted in a change to the corrective action and the structure of the financial administration for the organization.

Furthermore, the Plan indicated that keeping Titan Management responsible for preparation of the bank reconciliation's, the Plan could maintain an effective oversight and independent review over the financial process of the Plans financials. This change also resulted in the hours of work necessary for the Bookkeeper to be reduced to Part-time.

The Plan stated the new structure resulted in a four tiered hierarchy for the administration and oversight of the Plans financial mechanism. The four tiers consists of, (1) the Board of Directors, who oversee the process as a whole, (2) the Controller, who oversees the functions of the CPA, reconciliation's, and Bookkeeper, (3) the Reconciliator, who oversees the bank reconciliation's and the functions of the Bookkeeper, and (4) the Bookkeeper, who performs the day-to-day functions of A/P, entry posting, and deposits. The Plan specified this hierarchy readily demonstrates a clear administrative capacity to oversee the financial aspects of the Plan now and into the future.

In its response, the Plan also enclosed (1) its organizational chart indicating the name and title of its management and administrative staff, and (2) provided a detailed narrative of each individuals responsibilities and their time allocated to Plan business. The Plan also provided a listing of its contractors for administrative services and a detailed description of the services performed by each contractor.

**The compliance efforts described above are responsive to the deficiency cited.**